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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 563.

UNITED STATES OF AMERICA,

Petitioner,

v.

L. MANUEL HENDLER, AS TRANSFEREE OF CREAMERIES, INC., (FORMERLY HENDLER CREAMERY CO., INC.),

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

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INDEX.

Citations.

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OPINIONS BELOW.

The opinion of the District Court (R. 169-189) is reported in 17 F. Supp. 558. The opinion of the Circuit Court of Appeals (R. 200-204) is reported in 91 F. (2d) 680.

JURISDICTION.

The judgment of the Circuit Court of Appeals, affirming the judgment below, was entered August 7, 1937 (R. 200).

The petition for a writ of certiorari was filed November 6, 1937, and was granted December 6, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether in a statutory reorganization under Section 112 of the Revenue Act of 1928 the assumption of liabilities (debts and contracts) of the transferor corporation by the transferee corporation constitutes *recognizable* taxable gain to the transferor?

STATUTE INVOLVED.

The pertinent provisions of the Revenue Act of 1928 appear in the Appendix to Petitioner's Brief, pp. 17-19.

STATEMENT.

While Respondent is mindful of the rule forbidding repetition in its brief of facts already set out in Petitioner's, the "statement" there made very inadequately covers the important facts and therefore conveys an erroneous impression as to the *reason* both for the early payment of the bonded indebtedness there referred to, and the method followed in accomplishing this. The Commissioner, as the record shows, treated and assessed *only this item* as "recognizable gain" to Hendler in the transaction, on a theory quite different, as will be later shown, from either that advanced by counsel in the District Court, or the still different one advanced in the Circuit Court of Appeals by the new counsel there appear-

ing. Inasmuch as the brief for Petitioner in *this* Court seems to put forward, notwithstanding their inconsistency, all three of these successively advanced theories, it is necessary for Respondent at least to supplement Petitioner's "statement of facts" to the extent necessary to demonstrate that the *Commissioner's* theory, at least, is not supported by the facts, and that unless one or other of the *subsequently* advanced theories is sound,—that *all* obligations assumed constitute "recognizable gain",—then *this* item of "bonded debt" stands on no different footing from the other "assumed debts", of more than twice that amount.

Petitioner's "statement" says nothing of the highly significant fact that the "bonded debt" therein referred to constituted less than one-third part of the total obligations of Hendler assumed by Borden. Not only were Hendler's contracts, leases, etc., all assumed, but over $1,050,000 of current bank loans, $130,410.78 of merchandise accounts, and in fact all liabilities of the Hendler business, whether matured or contingent, as of the day of transfer, were also included in the obligations so assumed (R. 154, 156). Moreover, the statement emphasizes (Petitioner's brief, p. 3) that Hendler directors "called" the bonds on May 15th, 1929, "nearly a week before the operative agreement of May 21, 1929, (brief p. 4),—manifestly implying that *Hendler* therefore made the *bond* payment a *special* requirement. But in fact the *formal* agreement of May 21, 1929, had been preceded by one of similar tenor dated April 16, 1929, executed by Borden (R. 143), so that the *May* agreement was the mere formal execution by the two companies of one to which the controlling stockholders of Hendler had already also bound Hendler (R. 149).

Petitioner's brief and argument also imply, though do not assert, that (brief, bottom p. 11) the method might equally well have been followed of Borden "giving the money directly to Hendler and Hendler itself paying the bondholders"—in other words, that this was a mere plan used here as in the Minnesota Tea Co. case (No. 106, present term), of adopting a mere *form* in order to avoid a tax. As will be shown, none of these intimations has any real basis in fact.

The Commissioner's theory in assessing as taxable gain this item of bonded debt alone while not so treating the assumption of the other money debts of over $1,180,400 was, as he states in his letter of March 26, 1934 (R. 123), that this item was "constructively received."

Here it should be noted that Petitioner is in error in its brief (p. 12) in stating that "assumption of indebtedness is sometimes referred to as constructive receipt." Neither the Commissioner nor counsel for the Government in the District Court meant *mere assumption,*—they meant that *this particular bond money was so paid over as in effect to have gone to Hendler direct.* The Commissioner never even suggested that the *other* debts which were likewise assumed and discharged constituted "constructive receipt", of cash to that amount, by Hendler.

Evidently the thought was that because the bonds were paid so soon (July 1, 1929) after the date of closing (June 21, 1929) there was some special requirement on Hendler's part that these be paid on that date, and that it was practically Borden paying Hendler and then the latter itself paying the bonds. While Government counsel in the District Court evidently placed no reliance on this theory (it was practically abandoned alto-

gether by counsel in the Circuit Court of Appeals), in the Government's brief in the District Court the Commissioner's thought is expressed as follows:

> "The liquidation of the bonds of Creameries, Inc. (Hendler) by the Borden Co. was a separate, distinct and essential part of the consideration for the conveyance of the assets of said Creameries, Inc."

No attempt was made, however, either in the brief or otherwise, to sustain this assertion by reference to the *facts* in evidence. On the contrary, the facts show directly the contrary,—it was not Hendler but *Borden* who required that any "bonded" debt be eliminated at as early date as possible, and this could be done, in accordance with the provisions whereby the Hendler bonds were callable, *only at the first interest date* (Jan. and July) and after thirty days' notice (R. 4-5). The Borden Company's "capital structure consisted only of common stock and the Company had no funded debt" (sixth line from bottom p. 150 of R.). Manifestly, therefore, it was unwilling to carry among its obligations a *bonded* or *mortgage* debt, which in its "financial statement" would have to be shown as a lien against part of its assets acquired from Hendler. If not "called" thirty days before July 1, 1929, this "funded debt" could not be called or retired before January 1, 1930. Hence *Borden* (*not* Hendler) made as a condition of Borden's offer,—as one of the *considerations passing to Borden,* not *Hendler,*—that these bonds should be called in time to enable Borden to retire them July 1, 1929. In the preliminary offer of April 16, 1929 (R. 143) made by Borden to Hendler and accepted by Hendler controlling stockholders on April 16th (R. 149), it is expressly stated (R. 146), that:

> "It is a condition of our obligation hereunder that the said First Mortgage Bonds and Prior Preference Stock be called for redemption on July 1, 1929."

And both the preliminary (R. 146) and the final agreement (R. 12) required that the "call" be made not later than May 21, 1929. As the real contract had already been made on April 16, 1929, the directors issued the required call on May 15,—a month after, rather than "a week before", the date of the *real* binding agreement.

The formal agreement of May 21, 1929, provided for the closing of the transfer on June 21, 1929 (R. 19);—but contemplated the possibility, always present in such a transaction, of delay and consequent adjournments being necessitated by arising of unexpected obstacles (R. 19). However, the bonds, after being "called" for July 1, 1929, would have to be *paid* that day, regardless of this delay. Hence the agreement further provided,—*not* that *Borden* in that event would provide Hendler the money to pay the bonds, but that Hendler might borrow the necessary amount and add this (R. 10, 177-178) to the indebtedness shown on the balance sheet of December 31, 1928, representing the debts to be "assumed" by Borden (R. 9, 178), and which debts were not except in this event to be increased otherwise than by usual indebtedness incurred in the ordinary course of business. Not only did Borden not agree in that event to supply, loan or advance the money, but it did not agree even to reimburse Hendler.

It merely agreed that if necessary delays occurred beyond June 21, 1929, and if consequently Hendler, having "called" the bonds, had been compelled to borrow money for that purpose, and thus convert this "funded debt" into an ordinary bank debt (like the other $1,050,-000 shown on the balance sheet of December 31, 1928), then *if* and when the transaction later went through, instead of Borden taking subject to the original *bond* debt, it would take subject to and assume a correspondingly in-

creased bank indebtedness owing by Hendler, Hendler to furnish a "satisfaction piece" showing that the mortgage had in fact been released and the *bond* debt lien discharged (R. 12, 178). Nor, in that event, was there any agreement as to the *time* when Borden should pay this additional money thus borrowed by Hendler. It would be, thereafter, in precisely the same status as the original bank indebtedness, as to which there was *no* agreement as to the *time* when Borden should pay this,—merely that Borden *assumed it*.

So far from it being a special consideration moving to *Hendler* that this provision should be included in the contract submitted by Borden, it would have been manifestly more advantageous to Hendler to have had *no* call of the bonds made until after Borden actually consummated the transaction. Under the contract as proposed by Borden, Hendler took the risk after issuing the call, not merely of a delay and of having *itself* to finance the meeting of the call, but of the very real possibility that the *Borden transaction might never go through at all.*

The requirement, as the agreements thus make clear, was one imposed by *Borden,* that the "bonded debt" should be changed into one *not* of that character, constituting a lien on the property.

Not only, as has been shown, was the purpose of providing for payment on July 1st of the bonded debt to *change the character* of this indebtedness, and the requirement that of *Borden* and not of Hendler, but the *method* followed in the payment of this bond debt is the only one which could have been followed. As has been said, the Petitioner's counsel in their brief here imply that the transaction could equally well have been handled by Borden paying to Hendler, and Hendler then itself discharging

its bonded debt, and that the only motive for adopting the "assumption" method was to avoid the technical "receipt" by Hendler of this money. Upon consideration, however, it will become clearly apparent that this is not the case. The transaction could not have been handled in any other way. This is a totally different situation from that presented in the recent Minnesota Tea case, *supra,* where the money *actually received* by the transferor, with which to pay its debts, was *primarily* "distributed" by it directly to its *stockholders,* who *then* paid these debts,—not only an available but a much simpler method evidently being for the Company to pay its debts direct. Here Borden *at no time could have paid the "bond money" to Hendler direct,* with protection to Borden. If the transfer went through (as it did) on the day set, June 21st, Borden would have taken over the property subject to this still unreleased mortgage, which it could *not* get released unless the necessary amount was paid to *the trustee under the mortgage.* The same situation would have existed had the matter been closed July 1st. If, on the other hand, still further delays occurred (as it was realized was quite possible), Borden could not safely *pay Hendler* the money with which to meet the July 1st call, thus performing in anticipation the "assumption" which it agreed to perform *only if the merger went through,*—because the obstacles which caused the delays might *never* be overcome. Hence *Borden,* if it was unwilling to take such risks, could handle the "bond debt" in no other way. As has also been shown, instead of payment on July 1, 1929, of the bond debt being a *requirement by Hendler,* Hendler was no more interested in the special *time* at which such was paid than in the *time* of payment of the much larger *bank* indebtedness, and it was *Borden's* requirement that the debt

be changed from the character of a *funded* one. Indeed, as the bonds would not have matured *unless called*, it was really a disadvantage to *Hendler* thus to mature them. Hence neither in fact nor in principle was there any distinction between "assumption of the bonded debt" and "assumption of all other debts" of Hendler, and therefore unless (which will now be discussed) the Petitioner's counsel are right in their contention that *all* obligations "assumed" constitute in a reorganization "taxable income" to the transferor, no justification existed or exists for taxing as income *this item alone*, as involving some special and peculiar feature making it taxable.

THE LAW OF THE CASE.

The opinions filed in both the District Court (R. 169) and the Circuit Court of Appeals (R. 200) so fully cover the questions here involved that Respondent can add little to but at most can emphasize the reasoning which led both Courts to the conclusion here assailed by the Petitioner as incorrect. While Judge Chesnut expressed the view (R. 184) that if the distribution is made pursuant to the plan of reorganization it is immaterial under the statute whether this is to stockholders or to creditors, his conclusion in no way depended upon this point. As he himself says (R. 186):

> "But finally on this point it is to be observed that this is really not the crucial point in this particular case, because neither in form nor in substance, did Hendler receive any money or property which was not distributed to stockholders. As to form, the money used to pay the bonded debt was never actually received or distributed, or retained by the corporation; and as to substance, all that Hendler received in the transaction (other than a comparatively small amount of cash distributed to preferred

stockholders) was common stock of Borden, representing the equity in its property, in exchange for the equity in Hendler property. The item of $534,297.40 was not taxable."

The Circuit Court of Appeals even impliedly holds (R. 204) that the distribution meant is that *to stockholders,* yet reaches the same conclusion as Judge Chesnut. The crucial question, as both Courts agree, is whether the statute either in fact provides or was intended to provide that the mere assumption of transferor's liabilities in a merger of this kind shall entail liability for "profit" tax upon the transferor corporation.

Petitioner's counsel in their brief cite various authorities in support of the proposition that in a *sale* the assumption and payment by the purchaser of a debt resting on the property, and owing by the seller, is part of the consideration received by seller, and to be taken into account in computing the seller's taxable "gain or profit". Respondent has never at any time questioned *that* proposition. If Hendler had merely made an ordinary *sale* of its assets to Borden, the assumption by Borden of a debt owing by Hendler, constituting a *lien* on such assets, would admittedly have been part of the consideration,—of the purchase price.

We are not dealing here with a *sale,* however, but with a *statutory reorganization,* as defined in a statute the very purpose of which was to make "non-recognizable" in such a case gain which in a *sale* would have been taxable income.

Both of the Courts below were clearly of the opinion that the assumption of liabilities in a *reorganization,* as defined by Section 112(i) (1) of the Revenue Act of

1928, was not intended to, and did not, subject the transferor corporation to a tax thereon (R. 175, 203).

> "The sections of the Act in question must be construed in view of the purposes which they were intended to effect. It is well known that the purpose was to provide for the exemption from taxation at the time of a business reorganization of the gains involved therein to the extent specified in the statute in order to remove impediments to corporate readjustments and also to prevent the recognition of fictitious gains or losses. The history of the legislation and the committee reports in Congress clearly manifest this legislative intention. C. H. Mead Coal Co. v. Commissioner, 72 F. (2d) 22, 27-28; Minnesota Tea Co. v. Commissioner, 76 F. (2d) 797, 802. Baar and Morris on Hidden Taxes & Corporate Reorganization, p. 244." (Circuit Court Opinion, R. 203.)

> "There have been very many such reorganizations since the statute in similar form was first enacted; and there have been numerous decisions holding reorganizations (involving this feature) nontaxable, without discussion of the point. See Coleman v. Commissioner, 81 F. (2d) 455, 456; G. & K. Mfg. Co. v. Commissioner 76 F. (2d) 454 (C. C. A. 4) (reversed 296 U. S. 389, and remanded to Board of Tax Appeals); Starr v. Commissioner, 82 F. (2d) 964 (C. C. A. 4); cert. denied, 298 U. S. 680; Watts v. Commissioner, 75 F. (2d) 981 (C. C. A. 2), affd. 296 U. S. 387; Tulsa Oxygen Co. v. Commissioner, 18 B. T. A. 1283; Frank Keel, 31 B. T. A. 212; National Pipe & Foundry Co. v. Commissioner, 19, B. T. A. 242; Fashion Center Building Co. v. Commissioner, 31 B. T. A. 167; Baar & Morris, Hidden Taxes in Corporate Reorganizations, p. 261. Cf. Dickey v. Commissioner, 32 B. T. A. 1283, and Brons Hotels, Inc. v. Commissioner, 34 B. T. A. 376 (six Commissioners dissenting). Furthermore the contention now advanced is contrary to the adminis-

> trative practice for more than ten years, under the statutes so worded and several times re-enacted. (United States v. Hermanos, 209 U. S. 337; Helvering v. Bliss, 293 U. S. 144, 151)." (District Court Opinion R. 175).

Respondent very earnestly submits, and certainly the view uniformly prevailing hitherto has been, that the manifest scheme of the reorganization statute (Section 112, Revenue Act of 1928, *supra*) is to exempt the selling corporation in a "reorganization" from *any* tax or "gain' involved therein except to the extent expressly specified in the statute. Applying that conception of the statute to the situation here, the entire transaction was non-taxable to Hendler Company except to the extent of any "other property or money" *received* by Hendler Company and not *distributed* to its stockholders. All other items of gain were by both the intent and the language of the statute excluded from taxability to Hendler Company. Otherwise stated, every item of gain in a "reorganization" within the definition of the statute is non-taxable except "other property or money" *received* by the transferee corporation, and not *distributed* to its stockholders. Admittedly Respondent distributed all the property and money it received, pursuant to the plan of reorganization.

The Petitioner's representatives *concede* that although the "profit" realized, had this transaction been treated and taxable as a *sale*, was over $6,000,000.00, yet because of the *reorganization* provisions of the revenue laws, at least the far greater part of this profit is "non-recognizable". See H. Reg. No. 179, 68th Cong., 1st Sess., pp. 13-16.* The Commissioner did not consider the profit

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* Excerpt from this report in Appendix, p. 26.

recognizable to the extent even of the full amount of *obligations assumed*,—he excluded not only the other "cash" liabilities of $1,180,410.78, but the value to Hendler of the "relief" from other of its obligations assumed by Borden,—taking into account *only* this one "bonded debt" obligation.

As matter of fact, the *actual* "profit", on a "sale" basis was not merely $6,608,712.65, as estimated by the Commissioner, but at least $7,789,124.43. The Commissioner failed to include in his "sale price" the $1,180,-410.78 of *other* cash liabilities, likewise assumed (R. 109, 156). And if a calculation could be made of the value of the still other contracts and current debts assumed, the "profit" would be still greater.

By both the courts below Petitioner's then counsel were asked, but were unable, to explain Commissioner's failure to assess these *other* "debts assumed". In their brief in this Court counsel do not even refer to this inconsistency.

Prior to the Revenue Act of 1924 the existing law did not provide that even a "merger", in the type of case here presented, should be treated not as a *"sale"* but as a *non-taxable* or "statutory reorganization". The necessity for including it among those already made non-taxable by the Act resulted in the amendment in the Act of 1924 and continued in the Act of 1928.*

It is very earnestly submitted that Congress clearly intended to make possible, mergers such as this without

*** See quotations from Report of House Ways and Means Committee, 1924 when the pertinent provisions of the reorganization statute were revised and adopted. Also "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department, and the Reasons Therefor" prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury (Appendix, *infra* pp. 26-29).**

any "profit tax" resulting, and must necessarily therefore have intended to exclude "assumption of liabilities" as a taxable item of "profit", *because no reorganization of a going business in this manner could be effected without involving the taking over by the transferee not merely of the cash liabilities, but of all other existing obligations, of the transferor corporation.*

What Congress did and intended to do by the enactment of Section 112 (d) of the Revenue Act of 1928 was to make non-taxable a reorganization in which "other property or money" was received and distributed, and in any event to make such a transaction taxable, only to the extent of "other property or money" actually *received* and *not distributed.* To interpret this sub-section otherwise would defeat the very purpose intended.

See Committee Reports Appendix pp. 26-29.

The theory of counsel for Petitioner in the District Court was that "assumption of debts" is *expressly* taxed as "other property". In the C. C. A. a directly opposite theory was advanced by different counsel, — that the item of "obligations assumed" is taxable because *there is no operative provision in the statute that specifically exempts such an item.* As both Courts below pointed out, this is a mere begging of the question whether the assumption by Borden of this liability, or *any* such liability of transferor, in a *reorganization,* within the definition of the statute, is "income" in the usual sense. The question here is not whether generally such an item constitutes "income", but what is the proper construction and intent of this particular section of the law.

The Commissioner in *Western Industries Co. v. Helvering,* 82 F. (2d) 461, 462, maintained that the transaction in that case was a *sale* and not a *reorganization* because

to bring it within the statutory definition of a "reorganization" there must have been:

(1) An agreement between the two corporations to combine their enterprises;

(2) The continued participation of the stockholders of the combining corporations;

(3) The *assumption* by the surviving corporation of the *liabilities* of the old company; and

(4) The dissolution of the transferor corporation.

This quotation of the Commissioner's contention in that case shows clearly that the view of the Commissioner has been that "assumption of liabilities" in a "reorganization" under Section 112 is not only a usual feature but indeed a necessary factor within the intention of the Section and, therefore, was not intended to be treated as either "income" to the corporation, or "other property and money" received by the corporation and necessary to be distributed in order to exempt the transferor corporation, a party to the reorganization, from gain.

And certainly the uniform *practice* of the Department, which not only this Respondent but other taxpayers had every justification to rely upon as its "interpretation" of the Statute, has been hitherto in accordance with that view. See Judge Chesnut's opinion (R. 175). While counsel protest (their brief p. 13) that the assertions to this effect of the courts below are not supported by *published rulings*, they do not deny that such has been the uniform *practice*,—a practice followed by the Commissioner in the *instant* case (for as seen, the one item of "debts" *here* assessed by him was assessed on a very different theory).

Quite apart from this controlling question, of the *intent* of the Statute, looking at the situation from a practical and common sense point of view, Respondent submits that *in reality Hendler Company itself* never actually received anything of *actual* value to it in this assumption by Borden, which was at most an agreement to protect Hendler against its creditors and other obligees. Such an agreement in no way *really* added to the protection which Hendler already had, in the liability which all the assets were then under *in any event* for the payment of debts, by operation of law. Some of these debts were secured by an express mortgage, but even the so-called unsecured debts had in practical effect an equal claim against the assets. The Sales-In-Bulk Act of Maryland, of which the Court takes judicial notice, expressly provides that the transferee of all the assets takes them subject to the claims of creditors. The item of $534,297.40 is therefore on no different basis from that of the other debts subject to which Borden took over the Hendler assets, and the value of these assets *exceeded by $8,000,000 the debts so secured.* Hence certainly no added "protection" was needed, or was of substantial value.

Indeed, it might well be argued that even such "benefit" as this entailed, enured automatically to Hendler stockholders, rather than to Hendler itself. After receiving the stock of Borden, Hendler without waiting for or without regard to the question of the performance by Borden of its assumption of Hendler debts, distributed to its stockholders all that it then had remaining, namely, the stock of Borden which it had received in exchange for all its assets. As soon thereafter as possible it was formally dissolved. Of course, such dissolution could not operate to the prejudice of Hendler creditors.

but they could follow the assets into the hands of the Hendler stockholders if their debts were not paid. In fact, that is what occurred in this very case, where the Government proceeded against the stockholders to collect the tax on the Hendler Company now in dispute. While Borden did not assume *this* debt, yet had *other* Hendler creditors, being unable to secure payment by Borden, similarly made demand on the Hendler stockholders for payments of *their* debts, unquestionably the Hendler stockholders could have invoked against Borden this direct obligation of assumption by Borden, although in form made with the Company and not with the stockholders, so that to all intents and purposes this assumption to the extent that it had value *was* distributed to and passed on for the benefit of the Hendler stockholders; that is to say, when there was distributed to them the Borden stock there was in effect by operation of law also distributed the agreement of Borden to protect against Hendler debts.

Such a view is suggested in a late work on the subject, —"Baar and Morris—Hidden Taxes in Corporate Reorganizations", Section 17, page 267.

While this suggestion of "Baar and Morris" is supported by very logical reasoning, in no sense does Respondent rely or find it necessary to rely, upon the soundness of such a theory. It is referred to because at least it illustrates the difficulty of treating such an intangible character of "benefit", as "other property or money received" by Hendler.

Petitioner further implies that had Borden paid Hendler direct the money with which it paid its own

debts, rather than Borden paying Hendler creditors direct, the "gain" would have been recognized; and that "assumption of debts" is a mere change of *method,* but not of *substance.*

Respondent very confidently replies that this is far from being a mere optional "change in method". A merger of "going businesses' cannot as a practical matter be effected by the process of transferee paying the transferor and letting it (the latter) itself discharge its debts. Many such debts are not yet matured or certainly owing and *cannot* then be paid.

Indeed the *amount* of many such may depend on future events. Just as *unperformed contracts* of the transferor must in such case be taken over by transferee, resulting in a possible "relief or gain" to transferor almost impossible to estimate in figures, so *current obligations* changing from hour to hour, and necessarily uncertain in amount, must likewise be taken over.

The recently decided case of *Minnesota Tea Company vs. Helvering, supra,* illustrates the difference between a "statutory reorganization" involving actual merger of *businesses* and one involving merely a transfer of *assets.*

In the Minnesota Tea Company case, *supra,* there was, in fact, no "merger" *of going businesses.* The Tea Company, in actual effect, merely transferred to the transferee a large part of its *physical* assets, at market value and *free of debts,* and retained its separate corporate existence. The transferee there assumed none of the corporate debts, contracts or obligations of the transferor, who consequently, in order to enable it to pass clear title in connection with the physical assets so sold or transferred, had to provide for the dis-

charge itself of all its own obligations. In no sense, as in the instant Hendler-Borden merger, did the transferee take the place of and practically become the substitute for or successor of the transferor. Hence the purchase price consisted in part of stock of the transferee, and in part of cash sufficient to enable the transferor to discharge these obligations. And there could at once be *definitely* determined the exact amount of "cash received and not distributed" by the Tea Company.

In the instant case, on the contrary, there was a complete merger not only of two companies but of *two going businesses*. Borden absorbed not only every asset of every kind of Hendler but every right, privilege and existing contract of Hendler, and in connection with this took over and assumed *every existing obligation* of Hendler, including not only its money debts but all its existing contracts and obligations of every kind. While, of course, the agreement of merger had to be based upon a "balance sheet" of Hendler, which at the time of consummation would remain *substantially* unchanged, necessarily, as contracts were being made and discharged from day to day, and even from hour to hour, it was agreed that changes in so-called "current obligations" should not be taken into account,—Borden was to get, and did get, *whatever* Hendler *then* owned and to assume, and did assume, as its *own* obligations *whatever* obligations Hendler *then* was under. See the contract (R. 3-22) and Chattel Deed (R. 151-155).

Apart from any other consideration, the very *impossibility of determining* the value to the transferor of mere "assumption of obligations", where a *going business* of the transferor is taken over, itself explains why Congress did not attempt to tax such. If the Government

counsel are right in their contention that the value to transferor of "relief from obligations" is ordinary taxable "income", not covered by the reorganization sections at all, then the value of *all* such relief,—not merely *part*,—is equally "taxable gain". Not merely in this case would the "bonded debt", "bank debt", and "merchandise debt" be the measure. *Other* debts "incurred in the regular course of business" would have to be calculated. Also the various *contracts* and *leases* taken over would have to be appraised,—some of the latter might well have been extremely onerous to Hendler. Borden assumed among other obligations Hendler's contingent liability to *damage* claims, as to certain types of which Hendler had no liability insurance (R. 13). Moreover, it might be an indefinite time in the future before the actual value of such "assumption of obligations" could be determined,—leaving the "tax liability" of transferor impossible of *then* ascertainment. Certainly a "gain" which is to be "taxable income" of a company going into a merger and then into dissolution should be gain the *exact amount* of which is ascertainable. It is not sufficient that *part* is ascertainable, otherwise the dissolving company might have to wait indefinitely before knowing *how much* tax it is required to pay.

Very confidently it is submitted that Congress could not have intended to bring about such an impracticable situation as would be entailed if all such items had to be valued and "taxable income" predicated upon them.

As has been seen, not only both of the Courts below but the Commissioner himself, as shown not only by his action in the instant case but by his similar action or at least acquiescence in all other cases until counsel advanced a contrary theory in this case, were clearly of the

opinion that it was the intent of the reorganization provisions of the Revenue Act to exempt the transferor in a reorganization from any tax except as to items expressly specified in said provisions. They were further clearly of the opinion that the items so specified are "other property or money received and not distributed" (to stockholders) and that the mere benefit to the transferor resulting from the transferee taking over the property subject to indebtedness or even expressly assuming such indebtedness of the transferor was not intended to be and is not either "other property or money" within the meaning of the statute,—that is to say, that these words mean things that not only can be physically or actually *received* by the transferor but which also are susceptible of *distribution* by the transferor.

Even Petitioner's counsel apparently agree that the theoretical gain resulting from "assumption of debts" *is not susceptible of distribution,*—as they say in their brief, page 12, "it is difficult to see how there could be any distribution of that income to any one, etc." Their contention, therefore, means that Congress intended that it should be utterly impossible ever to effect a complete merger of two going businesses in which the transferee takes over completely not only all assets but all current obligations of the transferor, without entailing the immediate recognition of "taxable gain" to the transferor to the extent of the value to it of this assumption of its obligations; because on their own admission such *cannot* be distributed, whether to creditors or to stockholders. They try to fortify such a strained and unnatural construction of the statute by saying in their brief, page 7:

"A contrary conclusion in the present case would operate to give Hendler a permanent exemption from

taxation of this income rather than a mere postponement of tax, which is all that the reorganization provisions were intended to accomplish."

And, page 12:

> "While those provisions were meant to facilitate the readjustment of corporate structure by easing the tax burden, they were plainly intended at most to postpone the incidence of the tax."

They of course do not mean this literally because certainly as to the Hendler *Corporation* there *is* a "permanent exemption" and not a mere "postponement" of a tax which would otherwise have been payable by it on the *admittedly* "non-taxable gain" (R. 109) resulting to Hendler from the transaction, and certainly also it is not *that same* tax which is either "postponed" or even passed on to some one else. Assuming, however, that what they mean is that Congress supposed and intended that there would thereafter be opportunity to tax some other taxpayer on all theoretical gain resulting both to the Hendler Corporation and to its stockholders from the transfer of the Hendler business and assets to Borden, certainly Congress did not anticipate or believe that the tax or taxes thus postponed and ultimately collectible would bear any real relation to the tax of which the transferor is thus relieved. For example, by providing that taxable gain to the Hendler stockholders, instead of being recognizable when their Hendler shares were liquidated by the distribution to them of the Borden shares, should be recognizable only when the Borden shares were ultimately disposed of, many new factors were brought in which necessarily would make the ultimate tax a far different one. Not only when the respective stockholders sell their Borden shares might the selling price be either much greater or much less than

the market value at the time of the merger, but the then actual status and income of the different stockholders might be very different, with resulting effect upon their rate of tax; and, of course, also the then rates of income tax might be very different. Little force, therefore, it is submitted attaches to the mere argument that "otherwise the Government will lose in tax". But, furthermore, it by no means follows that in the enactment of these provisions it was either foreseen or supposed that non-inclusion of "assumption of liabilities" in the "other property or money" which, unless "distributed", should be *then* recognizable taxable gain, would result in a permanent exemption of such gain. It is far more likely that it was supposed and intended that any theoretical taxable gain which was not either assessable to the transferor or passed on at least in some degree to the transferor's stockholders would become and remain subject to tax in the hands of the transferee. In a merger of this kind, in which the transferee takes over literally everything of the transferor,—both all its assets and its rights and all its liabilities and obligations,—the transferee substantially to that extent steps into the place and shoes of the transferor. Indeed, that has since been expressly covered by the enactment in the Revenue Act of 1936 of Section 113 (a) (7)* (see foot-

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*ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS. —Sec. 113 (a) [Revenue Act of 1936]. Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that— * * *

(7) TRANSFERS TO CORPORATION.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

note) providing that the basis of the transferee as to the assets so acquired shall be the same as that of the transferor, increased only to the extent that taxable gain was recognized to the transferor. Even should it be argued that this is applicable only to reorganizations consummated since the enactment of this section, it certainly shows what was always assumed, that is to say, that any theoretical gain not specifically covered in the reorganization provisions would still remain subject to tax when the same assets were later disposed of by the transferee. Of course, the amount of such tax might be very different, but, as has been shown, similarly the amount of the tax in any event would be very different.

CONCLUSION.

Again it is respectfully emphasized that outstanding throughout this litigation is the fact that this was a "genuine merger". The transaction here involved was based on no mere motive to avoid a tax and involved no step even suggesting an effort at such, or which was not a natural and indeed necessary one, totally regardless of any "income tax" question. In the outcome *all* the assets and *all* the obligations of all these companies became vested in one company rather than in several, and Hendler stockholders have merely exchanged their holdings in the smaller Hendler Company for holdings of supposedly corresponding value, of the one consolidated company, operating, on a larger scale, the same kind of business.

It is submitted upon the principles and authorities cited that L. Manuel Hendler, Respondent, is entitled to recover the amount sued for by him, $69,554.69 with interest thereon from date of payment, less $6,260.33 with in-

terest thereon from the date same was payable, which is $62,145.89, together with interest thereon from April 15, 1933, according to law. The decisions below should be affirmed.

Respectfully submitted,

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APPENDIX.

*H. Rep. No. 179, 68th Cong. 1st Sess. pp. 13-16:

"The provisions of Section 203 of the bill that no gain or loss is recognized from certain exchanges do not grant an exemption and are not so intended. These provisions are based upon the theory that the type of exchanges specified in Section 203 are merely changes in form and not in substance, and consequently should not be considered as effecting a realization of income at the time of the exchange. In other words, those provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or on such an exchange as amounts to a pure sale."

*S. Rep. No. 398, 68th Cong. 1st Sess., pp. 14-15:

"Paragraph (3) provides that no gain or loss is recognized if a corporation a party to a reorganization exchanges property for stock or securities in another corporation a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. The present ruling of the Treasury Department on this question is of doubtful legality and a statutory provision is most necessary.

"Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented on account of the provisions of the tax law. If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation."

*H. Rep. No. 179, 68th Cong. 1st Sess. p. 13:

"It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchange in which it is not desired to tax the gain or allow the loss. This results in definiteness and accuracy and enables a tax-payer to determine prior to the consummation of a given transaction the tax liability that will result therefrom."

*H. Rep. No. 179, 68th Cong. 1st Sess., p. 15:

"There is no provision of the existing law which corresponds to subdivision (d) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss (sic) to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss (sic) is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, but if it retains all or any part of the proceeds with the result that the transaction is in substance a real sale, then all or part of the gain shall be recognized."*

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* These are excerpts from reports made with respect to the bill that became the Revenue Act of 1924, which contained for the first time the provisions of the law involved. Section 208 of the Act of 1921 became Section 112 of the Act of 1928.

** "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department and the Reasons Therefor, prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury."

"Section 203 (e): There is no provision of the existing law which corresponds to sub-division (e) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that sub-division. The sub-division provides that if a corporation in connection with a reorganization transfers its assets to another corporation, a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is recognized, but if it retains the entire amount of proceeds with the result that the transaction is in substance a real sale, then the gain shall be recognized."

"A corporation, in connection with a reorganization may dispose of its assets in one of three ways: It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation, or, the new corporation may buy, with its stock and cash, from the stockholders of the old corporation, their stock and then liquidate the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of construc-

tive receipt by the selling corporation. If it adopts the third method, there is no theory on which any gain to the old corporation could be taxed. As a result of these considerations, sub-division (e) has been so drafted that the tax liability of the selling corporation is the same, no matter which of the three methods, set out above, is adopted. In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or, if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and the same result is reached that would have to be reached necessarily if the transaction were accomplished through the medium of a purchase by the new corporation of the stock of the old corporation followed by a liquidation of the old."

** This statement is set out in *Minnesota Tea Company v. Commissioner*, 34 B. T. A. 145.